

**BEFORE THE
PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA**

In Re: BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. Affordable Phone Services, Incorporated d/b/a
 High Tech Communications
 Docket No. 2010-14-C

 BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. Daltone & More Incorporated
 Docket No. 2010-15-C

 BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. Tennessee Telephone Service, LLC d/b/a
 Freedom Communications USA, LLC
 Docket No. 2010-16-C

 BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. OneTone Telecom, Incorporated
 Docket No. 2010-17-C

 BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. dPi Teleconnect, LLC
 Docket No. 2010-18-C

 BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a
 AT&T South Carolina v. Image Access, Incorporated d/b/a New Phone
 Docket No. 2010-19-C

AT&T SOUTH CAROLINA’S BRIEF IN SUPPORT OF ITS PROPOSED ORDER

BellSouth Telecommunications, Inc. d/b/a AT&T South Carolina (“AT&T South Carolina”) respectfully submits this Post-Hearing Brief that explains why the Public Service Commission of South Carolina (“the Commission”) should adopt AT&T South Carolina’s position, and reject the Resellers’¹ positions, on each of the three issues presented in this

¹ In this Brief, “Resellers” refers to: Affordable Phone Services, Incorporated d/b/a High Tech Communications; Daltone and More, Incorporated; Tennessee Telephone Service, LLC d/b/a Freedom Communications USA, LLC; One Tone Telecom, Inc.; dPi Teleconnect, LLC and/or dPi Telecommunications, L.L.C.; and Image Access, Incorporated d/b/a New Phone. Per the Stipulation filed in Docket 2010-19-C December 15, 2010, Tennessee Telephone

Consolidated Phase.² As explained in AT&T South Carolina’s opening statement, these three issues are at the heart of approximately \$5 million in South Carolina-specific billing disputes that are the subject of AT&T South Carolina’s Complaints against the Resellers in the underlying individual dockets, and AT&T South Carolina believes the total amount in dispute with these and other resellers who take similar positions across the country exceeds \$150 million. Critically, these dollar amounts grow on a daily basis because the Resellers continue to “dispute” (and therefore withhold payment of) significant amounts they are billed by AT&T South Carolina, and they have made clear that they will continue doing so pending a Commission determination of the three issues in this Consolidated Phase. AT&T South Carolina, therefore, respectfully requests that the Commission decide these three issues in AT&T South Carolina’s favor as quickly as possible, and AT&T South Carolina is willing to present oral argument on an expedited basis if the Commission desires it.

Section I (the longest section of this Brief) addresses cashback offerings, and it consists of two subsections. Subsection I.A explains, among other things, that AT&T South Carolina’s method of applying the Commission-approved 14.8% resale discount rate to the promotional price of a service is consistent with the FCC’s *Local Competition Order*, the Fourth Circuit’s *Sanford* Decision, commission decisions and proposed recommendations in other states, and the economic reality that a cashback benefit is a reduction to the price of the service. Subsection I.B explains, among other things, that: the Resellers’ various positions on cashback are solutions in search of a problem that does not exist (because when appropriately viewed over any reasonable

Service, Inc. d/b/a Freedom Communications USA, LLC is not participating in this Consolidated Phase but has agreed to be bound by all rulings and determinations made in this phase.

² These three issues are: how cashback credits to the resellers should be calculated; how credits to resellers for waiver of the line connection charge should be calculated; and whether the word-of-mouth promotion is available for resale and, if so, how the credits to resellers should be calculated. See Joint Motion on Procedural Issues at 2.

period of time, AT&T South Carolina's method does not result in wholesale prices that are higher than retail prices and, even if it did, AT&T South Carolina's method does not impede a Resellers' ability to compete); the Resellers' Method 1 and Method 2 (described below) distort the Commission's avoided cost discount; the Resellers "price squeeze" arguments are without merit; the Reseller's "rebate" argument is without merit; and adopting any of the Resellers' proposals would have a chilling effect on promotional offerings, to the detriment of South Carolina consumers.

Section II addresses line connection charge waiver ("LCCW") promotions. It explains that a retail customer pays zero for the line connection, and under AT&T's South Carolina's method, a Reseller that qualifies for a LCCW promotion also pays a net of zero for the line connection. It further explains why the Resellers are wrong when they claim that when AT&T South Carolina waives a line connection charge for a retail end user, it must actually *pay* a Reseller for ordering a line from AT&T South Carolina.

Section III addresses referral marketing programs such as the "word of mouth" offering that provides qualifying AT&T South Carolina retail customers promotional benefits if they convince friends and family members who are not AT&T retail customers to purchase particular AT&T services. This Section explains that these benefits are not telecommunications services AT&T South Carolina offers to its end users but, instead, they are benefits retail customers receive when they perform marketing (not telecommunications) services for AT&T South Carolina. Accordingly, the Resellers are wrong when they claim that AT&T must "resell" these referral marketing promotions by paying a Reseller a word-of-mouth referral benefit when one of that Reseller's end users convinces friends and family members to purchase services, not from AT&T, but from that Reseller.

I. CASHBACK PROMOTIONS

As explained below, federal law provides that prices for resold telecommunications services shall be set on the basis of retail rates charged to subscribers for the service requested, excluding the portion thereof attributable to costs that are avoided when an incumbent local exchange carrier (“ILEC”) like AT&T South Carolina provides a service on a wholesale basis rather than on a retail basis. In 1997, after reviewing hundreds of pages of testimony, transcripts, and argument, the Commission implemented this requirement by establishing a uniform resale discount rate of 14.8% for the residential services at issue in this docket. *See Order on Arbitration, In re: Petition of AT&T Communications of the Southern States, Inc. for Arbitration of an Interconnection Agreement with BellSouth Telecommunications, Inc.*, Order No. 97-189 in Docket No. 96-358-C at 14 (March 10, 1997). The Commission established this uniform discount percentage by excluding from aggregate retail prices the aggregate costs “that reasonably can be avoided when an incumbent LEC provides a telecommunications service for resale at wholesale rates to a requesting carrier,” including, among other items, product management and sales, advertising, customer services, corporate operation, and uncollectibles.” *See, e.g.*, 47 CFR § 51.609 (b), (c). Granting the Resellers’ requests for more credits than the federal Act and the Commission’s orders mandate would be tantamount to ignoring the 14.8% avoided cost discount percentage this Commission established nearly 15 years ago and has used ever since.

A. AT&T South Carolina Correctly Applies the Commission-Approved 14.8% Resale Discount Rate to the Promotional Price of the Service.

AT&T South Carolina uses a two-step process to resell a telecommunications service that is subject to a retail cashback promotion: (1) a Reseller orders the requested telecommunications service and is billed the standard wholesale price of the service (which is the standard retail price

of the service discounted by the 14.8% resale discount rate established by the Commission); and (2) the Reseller requests a cashback promotional credit which, if verified as valid by AT&T South Carolina, results in the Reseller receiving a bill credit in the amount of the face value of the retail cashback benefit discounted by the 14.8% resale discount rate established by the Commission.³ (See Stipulations for Consolidated Phase at ¶¶7-9; Taylor Direct at 14-15).

To illustrate AT&T South Carolina's method, assume a promotion that provides qualifying retail customers a one-time \$50 cashback benefit when they purchase a service with a monthly price of \$80. If a Reseller qualifies to purchase this promotion for resale, AT&T South Carolina gives the Reseller a \$42.60 promotional cashback credit, which results in the Reseller paying a net of \$25.56 for the first month of service:

Amount Reseller was Billed Initially:	\$68.16 (\$80 discounted by 14.8%)
<u>Amount Reseller is Credited:</u>	<u>(\$42.60) (\$50 discounted by 14.8%)</u>
Net Reseller Pays For "Cashback" Month	\$25.56

(See AT&T South Carolina's Opening Statement, Tr. at 9-10; Powerpoint Presentation at Slide 6). This net amount of \$25.56 for the first month of service appropriately reflects a 14.8% discount from the \$30 promotional price (\$80 standard price less \$50 cashback) a retail customer would pay for the first month of service.⁴

³ This second "verification" step is necessary to confirm that a Reseller actually qualifies for the credits it requests. dPi, for instance, has systemically requested line connection charge waiver promotional credits for which it did not qualify, and it has filed complaints with several state commissions that challenge AT&T's rejection of those requests. To date, the Kentucky, Florida, and North Carolina commissions have ruled in favor of AT&T. dPi did not appeal the Kentucky Commission's decision, a federal district court in Florida has upheld the Florida Commission's decision, and the Fourth Circuit has upheld the North Carolina Commission's decision. Composite Attachment A to this Brief are copies of the Kentucky Commission, Florida District Court, and Fourth Circuit decisions.

⁴ As demonstrated in Section I.A.4 below, giving a Reseller a \$42.60 cashback credit in this example provides the same net benefit the Reseller would have received if AT&T South Carolina had simply reduced the retail price of the service by \$50.

As the discussion above shows, AT&T South Carolina's method is mathematically identical to applying the Commission-approved 14.8% resale discount percentage *exactly once* to the \$30 promotional price of the service:

$$\text{Wholesale} = \text{Promotional Price} - [(\text{Promotional Price}) \times (\text{Resale Discount Percentage})]^5$$

The Resellers, therefore, are simply wrong in their “main contention here, and this will be said over and over again, . . . that AT&T applies the resale discount twice, improperly. Does it more than once. Double dips, if you will, when it only appropriately should be applied once to the price.” (Resellers’ Opening, Tr. at 31). Clearly, AT&T South Carolina does not apply the resale discount twice – instead, it applies it only once, and it applies it to the promotional price of the service. That is why each witness in this Consolidated Phase agrees that the “cashback” issue boils down to whether the 14.8% resale discount rate is to be applied to the standard retail price of the affected service and not to the cashback benefit (as proposed by the Resellers)⁶ or the retail promotional price of the service (which is mathematically equivalent to AT&T South Carolina’s two-step method of discounting the standard retail price and the cashback benefit). (See Taylor Rebuttal, Tr. at 83; Gillan Rebuttal, Tr. at 216; Klein Rebuttal, Tr. at 278). As explained below, applying the discount once to the promotional price of the service as advocated by AT&T South Carolina is consistent with the FCC’s *Local Competition Order*, the Fourth Circuit’s *Sanford* decision, and decisions rendered in other states to date.

⁵ The [(Promotional Price) x (Resale Discount Percentage)] portion of this formula uses the Commission-approved 14.8% resale discount to estimate the avoided cost of the service. AT&T’s method, therefore, sets the wholesale price of a promotional offering on the basis of the promotional price of the service, excluding the portion thereof attributable to avoided costs. As explained in Section I.A.1 below, this is exactly what the FCC envisioned in its *Local Competition Order*.

⁶ To continue the example above, the Resellers agree that they should initially be billed \$68.16 for the first month of the service (which is what AT&T South Carolina does), but they argue that they should receive a bill credit of the full \$50 retail cashback value, resulting in their effectively paying only \$18.16 for the first month of the service.

1. AT&T South Carolina's Method is Consistent with the FCC's *Local Competition Order*.

Applying the Commission-approved 14.8% resale discount to the promotional price of a service is consistent with federal law as implemented by the FCC in its *Local Competition Order*.⁷ The 1996 Act provides that prices for resold services shall be set “on the basis of **retail rates charged to subscribers** for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.”⁸ In its *Local Competition Order*, the FCC anticipated that state commissions would implement this requirement by adopting resale discount percentage rates like the 14.8% rate established by this Commission – in fact, the FCC itself adopted “a default range” of such resale discount rates that state Commissions could select, on an interim basis, until they established permanent discount rates on the basis of cost studies.⁹ The FCC explained that when avoided costs are determined in this manner, state commissions “may then calculate the portion of a retail price that is attributable to avoided costs by multiplying **the retail price** by the discount rate.”¹⁰ Clearly, the 14.8% resale discount rate established by this Commission is to be applied to the “retail price” of the services that are being resold.

The FCC, however, understood that as competition developed in the local exchange market, the traditional “standard tariffed price” would not accurately reflect what a given

⁷ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499, (1996)(*Local Competition Order*), *subsequent history omitted*. In this Order, the FCC concluded that it was “especially important to promulgate national rules for use by state commissions in setting wholesale rates” that will “produce results that satisfy the intent of the 1996 Act,” and it stated that “[t]he rules we adopt and the determinations we make in this area are crafted to achieve these purposes,” *Id.* at ¶907.

⁸ 47 U.S.C. § 252(d)(3)(emphasis added).

⁹ See *Local Competition Order* at ¶ 908.

¹⁰ *Id.* (emphasis added).

customer pays for a telecommunications service any more than the sticker price accurately reflects what a given customer pays for a car. Accordingly, the FCC expressly decided what constitutes the “retail price” to which a percent resale discount rate is to be applied when a resold service is the subject of promotional pricing like the cashback offerings at issue in this proceeding. Contrary to the Resellers’ position, the FCC found that it is the reduced promotional price – and not the “standard” price – to which the 14.8% resale discount rate appropriately is applied.

Specifically, in discussing how incumbent LECs are required to make promotions available for resale, the FCC acknowledged that there was a “question of whether all short-term promotional prices are ‘retail rates’ for purposes of calculating wholesale rates pursuant to section 252(d)(3),”¹¹ and it concluded that “short-term promotional prices do not constitute retail rates for the underlying services and are thus not subject to the wholesale rate obligation.”¹² The FCC then noted that “[w]e must also determine when a promotional price ceases to be ‘short term’ *and must therefore be treated as a retail rate for an underlying service*,” and it concluded that a promotional price ceases to be “short term” when it is offered for a period of time “greater than 90 days in duration.”¹³ Because such promotional prices are not “short term,” the FCC found that they “must therefore be treated as the *retail rate* for an underlying service.”¹⁴

The FCC, therefore, expressly determined that avoidable costs are calculated by “multiplying *the retail price* by the discount rate.”¹⁵ The FCC also expressly determined that when a promotional price is offered for a period of time greater than 90 days in duration (as is

¹¹ *Id.* at ¶ 949 .

¹² *Id.*

¹³ *Id.* at ¶ 950.

¹⁴ *Id.* (emphasis added).

¹⁵ *Id.* at ¶ 908 (emphasis added).

true of the cashback offerings at issue in this proceeding), it is that lower “promotional price” that “*must . . . be treated as a retail rate* for an underlying service.”¹⁶ This is why, as explained more fully below, the Fourth Circuit affirmed the North Carolina Commission’s conclusion that when cashback incentives are offered, it is appropriate to apply the percent resale discount rate to the resulting promotional price. *See BellSouth Telecom. Inc. v. Sanford*, 494 F.3d 439 (4th Cir. 2007); *CMC Telecom, Inc. v. Michigan Bell Tel. Co.*, 654 F.Supp.2d 677, 686 (W.D. Mich. 2009) *aff’d in part and rev’d in part (on other ground)* __ F.3d __ (16th. Cir. 2011). (“The Fourth Circuit Court of Appeals upheld the State Commission’s determination that the promotional offering, because it lasted more than 90 days, was a standard retail offering which must be subject to resale at the wholesale rate.”).¹⁷

This, of course, is fatal to the Resellers’ arguments because, as the Resellers’ witnesses concede, the FCC’s rules are necessarily consistent with the FCC’s determinations in its *Local Competition Order*. (See Composite Hearing Ex. No. 12, Gillan Depo at 10; Klein Cross, Tr. at 297). Accordingly, any interpretation of the FCC’s rules that is inconsistent with the FCC’s determinations in the *Local Competition Order* is necessarily wrong and must be rejected. Because it is at odds with the plain language of the FCC’s *Local Competition Order*, the Resellers’ claim for the full, undiscounted retail cashback amount must be rejected.

¹⁶ *Id.* at ¶ 950. The Eight Circuit Court of Appeals affirmed this decision, ruling that “the [FCC’s] determination that promotional rates that are effective for more than 90 days qualify as ‘retail rates’ is a reasonable interpretation of the Act’s terms and was not made arbitrarily or capriciously.” *See Iowa Utilities Bd. v. FCC*, 120 F.3d 753, 819 (8th Cir. 1997), *reversed sub nom. AT&T Corp. v. Iowa Utilities Bd. on other grounds*, 525 U.S. 366 (1999).

¹⁷ Indeed, discounting the face value of the retail cashback benefit by the resale discount rate established by this Commission provides the resellers a lower wholesale price than they are entitled to receive, because it does not take into account the coupon redemption rate, the in-service life of the subject customer, or the net present value of a one-time upfront payment associated with the promotion. The parties agree, however, that this issue is not before the Commission in this Consolidated Phase. *See Joint Motion on Procedural Issues*, p. 2, n.2.

2. AT&T South Carolina's Method is Consistent with the Fourth Circuit's *Sanford* Decision.

AT&T South Carolina is aware of only one court decision that addresses the resale of cashback offerings: *BellSouth Telecom. Inc. v. Sanford*, 494 F.3d 439 (4th Cir. 2007)(*Sanford*). There, the Fourth Circuit “conclude[d] that the [North Carolina] Commission correctly ruled that ‘long-term promotional offerings offered to customers in the marketplace for a period of time exceeding 90 days have the effect of **changing the actual retail rate to which a wholesale requirement or discount must be applied.**’”¹⁸ Noting the FCC’s finding that “a promotion or discount offered for more than 90 days became part of a retail rate that had to be offered to competing LECs,”¹⁹ the Fourth Circuit affirmed the North Carolina Commission’s conclusion “that when such incentives [like cashback or gift cards] are offered, **the nominal tariff (the charge that appears on the subscriber’s bill) is not the ‘retail rate charged to subscribers’ under §252(d)(3)** because the nominal tariff does not reflect the value of the incentives.”²⁰ And in an example demonstrating the application of the North Carolina Commission Order it affirmed, the Fourth Circuit clearly rejected the position espoused by the Resellers:

Suppose BellSouth offers its subscribers residential telephone service for \$20 per month. Assuming a 20% discount for avoided costs, BellSouth must resell this service to competitive LECs for \$16 per month, enabling the competitive LEC to compete with BellSouth's \$20 retail fee. Now suppose that BellSouth offers its subscribers telephone service for \$120 per month, but sends the customer a coupon for a monthly rebate check for \$100. According to the NC Commission's orders, **the appropriate wholesale rate is still \$16**, because that is the **net price paid by the retail customer (\$20), less the wholesale discount (20%).**²¹

This \$16 wholesale price that the Fourth Circuit affirmed, of course, is exactly the price that results when AT&T South Carolina’s method is applied to this scenario. (Taylor Rebuttal, Tr. at

¹⁸ *Id.* at 442 (emphasis added).

¹⁹ *Id.* at 452.

²⁰ *Id.* at 450 (emphasis added).

²¹ *Id.* at 450.

87-88). In sharp contrast, if the position the Resellers espouse is applied to this scenario, the wholesale price would be negative \$4 -- instead of the Reseller paying AT&T for the service they receive from it in this scenario, AT&T would actually pay the reseller \$4 each month when it provides the service to them.²² The Fourth Circuit made clear that this absurd result is *not* what the NC Commission Orders it affirmed require.

Because the *Sanford* decision so clearly validates AT&T South Carolina's position and so clearly refutes the Reseller's positions, the Resellers tried desperately during the hearing to deflect attention from the ruling. They claim, for instance, that "[t]he [*Sanford*] case rules against BellSouth. That is the first time I have ever heard a case lost by a party cited for the proposition that it helps them in a particular case." (Resellers' Opening, Tr. at 34). The Resellers' own witness, however, acknowledged that what BellSouth lost in *Sanford* was its argument that it was not required to make cashback offers available for resale, (Klein Cross, Tr. at 313), and AT&T South Carolina does not attempt to revive that argument in this proceeding. More importantly, the Reseller's own witness acknowledged that the Fourth Circuit's reason for rejecting BellSouth's argument is (as explained above) that cashback offerings "*have the effect of reducing the price of the service.*" (*Id.*)(Emphasis added). In Dr. Taylor's words, the Fourth Circuit said "'you can't treat this cashback as simply a feature of the . . . telecom service [as the Resellers contend]. It affects the price.'" (Taylor Summary, Tr. at 122).

By applying the Commission-approved 14.8% resale to the lower promotional price of the service, AT&T South Carolina treats the cashback benefit as affecting the price of the service (consistent with both the *Sanford* decision and the FCC's *Local Competition Order*). It is not surprising, therefore, that ultimately, the only thing the Resellers' witness could do was suggest

²² See Klein Cross, Tr. at 311-12. This negative \$4 amount is \$96 (the standard price of \$120 discounted by 20%) less \$100 (the full retail cashback value).

that the Fourth Circuit simply did not realize what it was doing in the *Sanford* case²³ and invite this Commission to be the first one in the nation to suggest that the Fourth Circuit was wrong.²⁴ AT&T South Carolina respectfully submits that the Commission should decline that invitation.

3. AT&T South Carolina's Method is Consistent with a North Carolina Commission Decision and with a Proposed Recommendation of an Administrative Law Judge in Louisiana.

In 2009, the North Carolina Commission held an evidentiary hearing to resolve a complaint by dPi regarding cashback promotions. A three-member panel of the North Carolina Commission issued a Recommended Order finding, among other things, that “AT&T should calculate the value of the promotional discount by deducting the wholesale discount from the retail value of the promotion.”²⁵ The Recommended Order notes that “[i]n its Proposed Order, the [North Carolina] Public Staff supported AT&T’s position that dPi would receive the same benefit of a price reduction equal to a promotional credit only if the wholesale discount were applied to the promotional credit,” and the Public Staff stated that it “supported AT&T’s position because AT&T calculated the discount in a manner that was consistent with the Fourth Circuit’s analysis in the *Sanford* decision.”²⁶ The Recommended Order then states:

The Commission agrees with AT&T and Public Staff. If the Commission were to adopt dPi’s position regarding promotional credits, then dPi would receive a greater benefit than it otherwise would be entitled to receive had AT&T merely reduced the telecommunications service’s rate. The example in O’Roark Cross-Examination Exhibit No. 4 demonstrated that the only way a [reseller] could

²³ See Klein Cross, Tr. at 313 (“They said that, but neither the North Carolina Commission nor the *Sanford* court were really aware of the rebate argument that I’ve been attempting to make here today. Now, the *Sanford* court *I’m aware you have said they called it a rebate*, but when, for instance, when [the Fourth Circuit] made up this example, *its really unclear whether a rebate is what’s going on with the cashback, or not.*”)(emphasis added).

²⁴ See Klein Redirect, Tr. at 326.

²⁵ See Attachment B to this Brief (a copy of the North Carolina Commission’s Recommended Order) at 20.

²⁶ *Id.* at p. 21.

obtain an equal benefit from rate reduction such as a promotional credit was to reduce the promotional credit by the wholesale discount rate.²⁷

Subsequently, the full seven-member North Carolina Commission affirmed this ruling over dPi's exception.²⁸

In 2010, the Administrative Law Judge presiding over dPi's cashback complaint against AT&T in Louisiana issued a Proposed Recommendation finding, among other things, that "[a]ll cash back promotions are to be reduced by the wholesale residential discount which in Louisiana has been established to be 20.72%."²⁹ The Proposed Recommendation explains that "[i]mposition of the wholesale discount is consistent with instructions found in the 1996 Telecommunications Act, FCC Rulings including the First Report and Order, and the LPSC Rules of Local Competition; all of which say that telecommunications services must be offered for resale **at the wholesale discount.**"³⁰

4. AT&T South Carolina's Method Is Consistent with the Economic Reality that a Cashback Benefit is a Reduction to the Price of the Service.

In addition to being consistent with applicable law, AT&T South Carolina's method also is consistent with economic reality. The Resellers' witnesses concede (as they must) that a \$50 one-time cashback benefit reduces the effective retail price of a resold telecommunications service by \$50. (Gillan Cross, Tr. at 246-47; Composite Hearing Ex. No. 12, Klein Depo. at 44).³¹ As a result of the "avoided cost" pricing standard in Section §252(d)(3), however, changes

²⁷ *Id.*

²⁸ Attachment C to this Brief is the North Carolina Commission's Order Denying Exceptions and Affirming the Recommended Order.

²⁹ See Attachment D to this Brief (a copy of the Louisiana ALJ's Proposed Recommendation) at p. 26. This Proposed Recommendation is not yet final, as that docket has been stayed until Louisiana Commission renders a decision in its Consolidated Phase proceedings.

³⁰ *Id.* at p. 25 (emphasis in original).

³¹ Dr. Klein's Deposition was entered into the record as Joint Exhibit 4.

in the retail price of a telecommunications service do not flow through to a reseller on a dollar-for-dollar basis. For example, if the standard retail price of a service is increased by \$50 (from \$30 to \$80, for example), the wholesale price for the service does not increase by \$50. Instead, it increases by only \$42.60:

	Retail	Wholesale
New Price	\$80	\$68.16 (\$80 discounted by 14.8%)
<u>Initial Price</u>	<u>\$30</u>	<u>\$25.56 (\$30 discounted by 14.8%)</u>
Difference	\$50	\$42.60 (\$50 retail difference discounted by 14.8%)

The Resellers' witnesses concede that, conversely, a \$50 reduction in the standard retail price of a service does not result in a \$50 reduction in the wholesale price of the service, but instead results in a \$42.60 reduction in the wholesale price of the service. (Gillan Cross, Tr. at 235; Hearing Exhibit No. 4; Klein Cross, Tr. at 303-04).³² It is entirely appropriate, therefore, that AT&T South Carolina provides the Resellers the same \$42.60 wholesale price reduction when the retail price reduction takes the form of a cashback benefit as the resellers would receive if it took the form of a \$50 reduction to the "standard price." (See Taylor Direct, Tr. at 54).

5. AT&T South Carolina's Method Produces Avoided Cost Estimates that are Proportional to the Net Amounts AT&T South Carolina Actually Receives for Its Retail Services.

The Resellers' witness Mr. Gillan testified when a percentage resale discount like the 14.8% discount established by this Commission is used to estimate avoided cost, "the avoided cost is proportional to the rate" (Gillan Cross, Tr. at 235) such that "cheaper services generally would have lower avoided costs, more expensive services generally would have higher avoided costs" (Gillan Cross, Tr. at 253). AT&T's method of applying the Commission-approved

³² To simplify the math, Hearing Exhibit No. 4 assumed a 20% resale discount, which resulted in a \$40 reduction in the wholesale price. When the actual 14.8% resale discount rate is used, the reduction is \$42.60.

14.8% discount to the promotional price produces that proportional result. Under AT&T's method, the avoided cost estimate is lower when AT&T South Carolina receives less net revenue for a service, and it is higher when AT&T receives more net revenue for a service.

In contrast, and as Resellers' witness Mr. Gillan concedes, the Resellers' method does not produce that proportional result. During his summary, Mr. Gillan discussed a service with a standard price of \$100 per month, a one-time promotional cashback benefit of \$50, and a 14.8% resale discount rate. (*See Gillan Summary, Tr. at 184-85; Hearing Exhibit No. 14*). On cross-examination, Mr. Gillan agreed that over the course of twelve months, AT&T South Carolina would receive \$1,150 from a retail customer who purchases that service under the cashback promotion, and it would receive more (\$1,200) from a retail customer who purchases that service without taking advantage of the cashback promotion. (*Gillan Cross, Tr. at 253*).

Mr. Gillan conceded, however, that despite his candid testimony that the avoided cost estimate should be proportional and, therefore, the estimated avoided costs should be higher for higher-priced services, the Resellers' proposed method estimates the avoided costs as exactly the same dollar amount in both cases. (*Gillan Cross, Tr. at 254*). The Resellers, therefore, want to ignore the actual net revenue AT&T South Carolina receives for a given service and assume that AT&T South Carolina always receives the "standard tariffed" price for a given service. Stated differently, the Resellers want to assume that the only way cost pressure is reflected in prices is through changes "to standard prices" rather than discounts and promotions. Their motive is as clear as it is self-serving – doing so inappropriately overstates the revenue, which inappropriately overstates the estimate of avoided costs, which in turn inappropriately understates the wholesale price the Resellers should pay for the service.

B. The Resellers' Attacks on AT&T's Method are Without Merit and Conflict with the FCC's *Local Competition Order*, the Fourth Circuit's *Sanford* Decision, and the Decision of Every Other State Commission to Have Considered this Issue to Date.

In essence, the Resellers launch a two-pronged attack against AT&T South Carolina's method. First, they claim that if one ignores what actually happens over time and focuses solely on the single month in which the cashback benefit is received, AT&T South Carolina's method forces Resellers to pay more than retail customers pay for the same service³³ – or, more accurately, in the single month in which the cashback benefit is received, AT&T's method provides a smaller net payment to a Reseller than it does to a retail customer. Second, they claim that a cashback benefit is somehow unrelated to the price of the service but, instead, is merely a “term or condition of the service” that must be passed along to the resellers on a dollar-for-dollar basis, without applying the Commission-approved resale discount to cashback benefit.³⁴ Neither prong of their attack, however, bears any merit.

1. Resellers' Method 1 and Resellers' Method 2 are Without Merit

The Resellers argue against AT&T South Carolina's method of discounting the cashback amount by claiming that it results in a situation where the wholesale rates are higher than retail. (See Gillan Summary, Tr. at 183-84). Attachment E to this Brief, which assumes that a one-time \$50 cashback promotional benefit applies to a service with a monthly retail price of \$32.50, illustrates what the Resellers erroneously argue is a problem with AT&T South Carolina's

³³ See, e.g., Gillan Summary, Tr. 187 (“For just this one month that the cash flows through the system, you have to decide, ‘well, what happens to the wholesale price in that one month’); *Id.* at 188. (“Now, AT&T will say all kinds of things about, ‘Well, you know, we still make money over months,’ blah blah blah. They are right. Nobody is arguing at all about whether or not it makes sense to sometimes offer a cashback promotion that [allegedly] produces a negative rate in one month. But . . . [w]e’ve only got one month that we’re worrying about.”)

³⁴ See, e.g., Klein Summary, Tr. at 292 (“So I think you have to see [the cashback benefit] as part of the terms and conditions of service, and not really the price.”).

method.³⁵ In this example, a retail customer who keeps the service for only one month would receive a net payment of \$17.50 from AT&T South Carolina.³⁶ Under AT&T South Carolina's method, if a Reseller qualified to resell this promotion and kept the service for only one month, it would receive a net payment of \$14.91 from AT&T South Carolina.³⁷ This situation – in which the Reseller would receive less money from AT&T South Carolina for keeping the service for only one month than a retail customer would receive from AT&T South Carolina for keeping the service only one month – is what the Resellers refer to when they argue that AT&T South Carolina's method results in a situation where the wholesale prices are higher than the retail prices.

a. Description of the Resellers' Proposed Methods

In post-hearing briefs filed in other similar proceedings, Resellers have offered not one, but two alternative methods of calculating wholesale prices that they claim are necessary to address their “wholesale is higher than retail” concerns.

i. Resellers' Method 1

The Resellers' first method (“Resellers' Method 1”) is:

$\text{Wholesale Price} = \text{Promotional Price} - [(\textit{Standard Retail Price}) \times (\text{Resale Discount Percentage})]$

(See Gillan Cross, Tr. at 239-40; Hearing Exhibit No. 7). Attachment F to this Brief demonstrates that this is mathematically identical to a Reseller paying the standard wholesale price for the service and then receiving a credit in the full retail amount of the cashback benefit.

³⁵ Attachment E is based on Hearing Exhibit No. 10, which Reseller witness Mr. Gillan concedes accurately reflects the application of AT&T South Carolina's method to the offering addressed at Table 1 on page 9 of his Direct Testimony. (See Gillan Cross, Tr. at 247-48; Hearing Exhibit No. 10).

³⁶ This is the net of the \$32.50 the retail customer pays for the service and the \$50 cashback benefit the retail customer receives from AT&T South Carolina.

³⁷ This is the net of the \$27.69 a Reseller pays for the service and the \$42.60 cashback benefit a Reseller would receive under AT&T South Carolina's method.

In other words, the Resellers want to have their cake and eat it too: they want to start with the benefit of the lower promotional price, but they want to use the *higher* standard price to calculate the avoided cost estimate. As explained below, this improperly overstates the avoided cost estimate, which improperly understates the price the Resellers should pay, which yields a resale discount that impermissibly exceeds the 14.8% discount established by this Commission.³⁸

ii. Resellers' Method 2

Implicitly recognizing the obvious flaws in Method 1, some Resellers have offered an alternative second method ("Reseller's Method 2"): make the wholesale price 14.8% less than the promotional price.³⁹ As demonstrated by Attachment G to this Brief, Resellers' Method 2 produces the same results as AT&T South Carolina's method when the cashback benefit is less than the monthly price of the service. This is not surprising, because in this scenario, Resellers' Method 2 is exactly the same as AT&T South Carolina's method:

$\text{Wholesale} = \text{Promotional Price} - [(\text{Promotional Price}) \times (\text{Resale Discount Percentage})]$

The difference between AT&T South Carolina's method and Resellers' Method 2 exists when the cashback benefit is greater than the monthly price of the service.

Consider again Mr. Gillan's example of a one-time \$50 cashback promotional benefit that applies to a service with a monthly retail price of \$32.50. AT&T South Carolina would apply the formula above exactly as it is written (and exactly as it has been applied in South Carolina for more than a decade):

³⁸ In the example set forth in Attachment F, for instance, Resellers' Method 1 yields a 39.5% resale discount instead of the appropriate 14.8% resale discount established by this Commission.

³⁹ dPi makes this argument in several of the cashback complaint proceedings it has filed with various state commissions, and the Resellers seem poised to make a similar argument in this proceeding. See Taylor Cross, Tr. at 135 (Counsel for New Phone asking Dr. Taylor, "So the question is, what is 14.8% less than negative \$25?").

$$\begin{aligned}
\text{Wholesale} &= \text{Promotional Price} - [(\text{Promotional Price}) \times (\text{Resale Discount Percentage})] \\
&= -17.50^{40} - [-17.50 \times .148] \\
&= -17.50 - [-2.59] \\
&= -14.91
\end{aligned}$$

In other words, under AT&T South Carolina's method, a Reseller would receive a net bill *credit* of \$14.91 for the first month of service.

In sharp contrast, the Resellers would abandon this longstanding formula and create an entirely different one in order to force a result that is "14.8% less than the promotional price." Instead of appropriately subtracting the avoided cost estimate from the promotional price, the Resellers would *add* the avoided cost estimate to the promotional price:

$$\begin{aligned}
\text{Wholesale} &= \text{Promotional Price} + [(\text{Promotional Price}) \times (\text{Resale Discount Percentage})] \\
&= -17.50 + [-17.50 \times .148] \\
&= -17.50 + [-2.59] \\
&= -20.09
\end{aligned}$$

Not surprisingly, the Resellers' Method 2 pads their own pockets by providing them a greater net bill credit for the first month of service than they are entitled to receive.

b. The Resellers' Methods Are Solutions in Search of a Problem that Does Not Exist – When Appropriately Viewed Over Any Reasonable Period of Time, AT&T South Carolina's Method Does not Result in Wholesale Prices that Are Higher than Retail Prices.

As the discussion of Attachment E above demonstrates, the Resellers' "wholesale is higher than retail" argument is the result of myopically focusing on a single month or two in isolation and ignoring the reality of what happens thereafter. It is hardly surprising that such an inappropriately narrow focus on a single month or two presents a distorted view of reality – one the Resellers use to erroneously suggest an anomaly in the application of the wholesale discount to a cashback promotion where none exists. Indeed, no aspect of a cashback promotion makes

⁴⁰ In this scenario, the retail customer would net a \$17.50 bill credit (*i.e.* -\$17.50) for the first month of service by paying \$32.50 and receiving a \$50 cashback benefit.

economic sense in such a short term, because it would be irrational for AT&T South Carolina to offer \$50 cashback to woo customers who will stay with the company for only a month or two.⁴¹ Likewise, the resale provisions in the 1996 Act are not intended to enable new entrants to win customers for a single month: that is not competition – it is churn. A proper understanding of the economics of a cashback promotion necessarily looks at a longer term.

In fact, prices are never evaluated by isolating a single month or two and ignoring what happens beyond that, because “[t]he market is to attract the customer, not to attract the customer for a month.” (Composite Hearing Exhibit 12, Taylor Depo. at 68). That is why Reseller witness Dr. Klein concedes that in considering pricing issues such as predatory or below-cost pricing, *“you would have to look at more than one month.”* (Klein Cross, Tr. at 301; Composite Exhibit 12, Klein Depo. at 57-58). Dr. Taylor carried this point from theoretical economics to practical reality accordingly: “You know the relevant price can’t be negative [as the Resellers erroneously contend] because if it were, the Justice Department in Washington . . . would come howling down on AT&T for predatory pricing But you know, that didn’t happen, that wouldn’t happen.” (Taylor Summary, Tr. at 124).⁴² Moreover, if the Resellers were correct in arguing that the first month of service must be viewed in isolation, the Commission historically would

⁴¹ Not surprisingly, the evidence of record shows that keeping a service for only one month is the exception rather than the rule. AT&T South Carolina’s witness Dr. Taylor testified that “on average, the customer tenure for these \$50 cashbacks is much, much longer than one month,” (Taylor Cross, Tr. at 146-47), and both of the Resellers’ witnesses agree that it is reasonable to assume that, on average, AT&T South Carolina’s retail customers who accept cashback offerings stay long enough to make it profitable to AT&T to make the offerings. (Composite Exhibit 12, Gillan Depo. at 43-44; Klein Depo. at 56).

⁴² See also Taylor Direct, Tr. at 67 (“it is important to recognize that the effective price is negative in the early months of serving a retail cashback promotion customer only because AT&T would not yet have earned enough from its monthly price to offset the upfront cashback payment.”); *Id.* at 68 (“What matters for competition is the totality of retail prices over the expected tenure of the average retail customer, not the effective price in the first month or two.”).

have required all companies to recover their “up front” costs in the very first month of service rather than facilitating affordable pricing by allowing “up-front” costs to be recovered over a reasonable amount of time. But that has never been the case in South Carolina – long before any statutory deregulation of the retail telecommunications market, Commission Staff witness Joe Rodgers testified that waiving installation charges did not present “below cost pricing” issues because even if the initial costs are not recovered on the front end, they are recovered over a reasonable amount of time.⁴³

And the Resellers cannot honestly claim that what they perceive as a “wholesale is higher than retail” persists for an unreasonable period of time – in the example addressed in Attachment E to this Brief, for example, that situation is forever reversed when the service is kept for more than a single month. As Attachment E shows, a retail customer who keeps the service two months pays AT&T South Carolina a net of \$15, and when a Reseller keeps the service for two months, it pays AT&T South Carolina a net of \$12.78 – a net amount that is not only *less* than what the retail customer pays, but that is less by the 14.8% resale discount rate established by the Commission. A Reseller likewise pays less than the retail customer when the service is kept for three, four, and any greater number of months, (Gillan Cross, Tr. at 248-49), and in such cases the Reseller always pays 14.8% less than the retail customer. Accordingly, Resellers’ proposed methods are nothing more than solutions in search of a problem that does not exist.

And if a Reseller’s business plan really is to win and keep customers for only a single month, there is no reason for the Commission to give it any special help. If that is the case, the Reseller clearly is attempting to game the system by collecting a cashback credit from AT&T

⁴³ See Transcript (at p. 210) of February 22, 2001 Hearing, *In Re: Southeastern Competitive Carriers Association vs. BellSouth Telecommunications, Inc.*) Docket No. 2000-378-C.

South Carolina, collecting higher-than-normal advanced payment from its credit-challenged end user, and then abandoning the end user. In fact, even under AT&T's method, affiliated resellers can profit by churning their customers as quickly as possible -- by rotating their customers among affiliates on a monthly basis, the parent company as a whole can avoid ever paying anything to AT&T for the services it resells and, instead, steadily be paid \$14.91 a month by AT&T in addition to the revenues its affiliates collect from their end user customers. The Commission should reject the Resellers' request to exacerbate this perverse incentive by increasing the amount of subsidy they receive when they keep an end user customer for only a single month.⁴⁴

⁴⁴ AT&T South Carolina respectfully submits that its concerns regarding affiliated resellers acting in concert are valid. BLC Management, LLC, for instance, is affiliated with a number of other resellers under the ATMS family of companies. *See* Attachments H and I to this Brief (Pleadings filed by the Office of Regulatory Staff). Attachment J to this Brief is AT&T's filing and a recent order from a federal district court in Florida that addresses a scheme by which one of BLC's affiliates (American Dial Tone, Inc.) assisted another of BLC's affiliates (LifeConnex LLC, f/k/a Swiftel LLC) in evading a Florida Commission Order requiring LifeConnex to post a \$1.4 million security bond to protect AT&T Florida. Additionally, several ATMS companies are currently under investigation by the Florida Staff in *In re: Investigation of Associated Telecommunications Management Services, LLC (ATMS) companies for compliance with Chapter 25-24, F.A.C., and applicable lifeline, eligible telecommunications carrier, and universal service requirements*, Docket No. 100340, and Attachment K to this Brief is a document obtained from Florida Staff describing the ATMS companies' various alleged misdeeds. Finally, ATMS companies have withdrawn their requests for ETC designation from at least this and at least one other state commission after staff in those states objected to the requests due to concerns about inconsistent information provided by those affiliates. *See* Staff's Recommendation filed on June 4, 2009 and Swiftel, LLC's Notice of Withdrawal filed on July 21, 2009 in Docket 070348-TX. *See* Office of Regulatory Staff's Motion to Dismiss, *In re: Application of LifeConnex Telecom, LLC for Designation as an Eligible Telecommunications Carrier*, Docket No. 2009-414-C, before the Public Service Commission of South Carolina (filed July 7, 2010); LifeConnex's July 23, 2010 letter withdrawing its petition in Docket No. 2009-414-C. *See* Office of Regulatory Staff's Motion to Dismiss, *In re: Application of Bellerud Communications, LLC for Certification as an Eligible Telecommunications Carrier*, Docket No. 2009-422-C, before the Public Service Commission of South Carolina (filed on July 9, 2010); Bellerud's July 23, 2010 letter withdrawing its petition in Docket No. 2009-414-C.

That sort of behavior merely pads the Resellers' pockets while providing no benefit whatsoever to South Carolina consumers, and it should not be rewarded or encouraged by giving Resellers an even larger cashback credit than they are entitled to receive. The pro-competitive policy of the 1996 Act is to encourage competition in the local exchange service market and to grant Resellers the opportunity to compete to obtain and keep customers. Looking at one month in isolation for the on-going service charges ignores the economic realities of the tenure of the end user customer and does nothing more than encourage Resellers to churn those end users off after one month of service. This tortures the 1996 Act into an arbitrage opportunity for resellers vis-à-vis the ILECs without providing any positive effect for the resellers' end user customers.

c. The Situation the Resellers Erroneously Characterize as “Wholesale is Higher than Retail” Does not Impede Their Ability to Compete.

Even if the Resellers were correct in arguing that AT&T South Carolina's method results in wholesale prices that are higher than retail prices for a month or two (and they are not), the Resellers are simply wrong when they argue incessantly that that the federal Act flatly prohibits wholesale prices that are higher than resale prices.⁴⁵ In its *Local Competition Order*, the FCC excluded short-term promotions from the federal Act's resale obligations and thus sanctioned retail prices that temporarily are higher than wholesale prices,⁴⁶ recognizing that

promotions that are limited in length may serve procompetitive ends through enhancing marketing and sales-based competition and *we do not wish to unnecessarily restrict such offerings*. We believe that, *if promotions are of*

⁴⁵ See Reseller's Opening, Tr. at 29 (“The only way [Resellers] could compete with AT&T was . . . to be able to purchase those services at wholesale rates that are lower than retail rates.”); *Id.* at 29 (“[W]holesale is always lower than retail. It has to be.”); *Id.* at 30 (“Wholesale is always less than retail.”). See also Gillan Summary, Tr. at 183.

⁴⁶ Assume, for example, a promotion that provides that for 90 days, retail customers pay \$50 a month for a service with a standard retail price of \$100 a month, after which they pay the standard monthly price of \$100. For 90 days, retail customers would pay \$50 each month for this service, while Resellers would pay the higher price of \$85.20 each month (\$100 less the 14.8% discount) for the same service.

limited duration, their procompetitive effects will outweigh any potential anticompetitive effects. We therefore conclude that short-term promotional prices do not constitute retail rates for the underlying services and are thus not subject to the wholesale rate obligation.

Local Competition Order, ¶ 949 (emphasis added). Contrary to the Resellers mantra, therefore, the FCC clearly contemplates – and even encourages – short-term “wholesale is greater than retail” situations.

The same policy considerations that led the FCC to exclude short-term promotions from the Federal Act’s resale obligations⁴⁷ apply with equal force to (and demand a rejection of) the Resellers’ “wholesale is higher than resale” argument. The cashback offerings at issue in this proceeding are the type of pro-competitive “enhance[ed] marketing and sales-based competition” the FCC envisioned, and they clearly benefit South Carolina consumers. By making it more expensive for AT&T South Carolina to offer these promotions (by causing AT&T South Carolina to pay higher credits than is appropriate), the Resellers’ proposed methods would discourage these pro-competitive promotions that are beneficial to consumers in South Carolina. And nothing in the record suggests that the Resellers’ proposed methods would in any way benefit consumers who purchase services from them.

The appropriate question, therefore, is not (as the Resellers suggest) whether a mathematically correct application of the discount yields a wholesale price lower than the retail price in each and every month. Rather, as the FCC made clear, the appropriate question is whether a mathematically correct application of the resale discount impedes Resellers from competing. Attachment L to this Brief clearly shows that the answer to that question is no, it

⁴⁷ AT&T South Carolina is not arguing that this “short term promotion exception” relieves it of its resale obligations with regard to the cashback promotions at issue in this proceeding.

does not. Attachment L is based on the following assumptions, which are consistent with Mr. Gillan's example in Table 1 of his Direct Testimony described above:

- (a) an AT&T South Carolina service has a retail price of \$32.50 per month;
- (b) the resale discount percentage is 14.8%;
- (c) when no cashback promotion is in effect, the Reseller purchases this service from AT&T South Carolina at a wholesale price of \$27.69 per month (\$32.50 discounted by 14.8%) and resells it at a price of \$30.50 per month (undercutting AT&T South Carolina's monthly retail price by \$2);⁴⁸
- (d) an AT&T South Carolina promotion offers a one-time \$50 cashback benefit with the purchase of this service;
- (e) AT&T South Carolina gives the Reseller a \$14.91 credit in the first month (the amount due under AT&T's South Carolina's position and, as demonstrated above, the amount due under a correct application of a 14.8% wholesale discount)⁴⁹; and
- (f) the Reseller actually passes the full \$50 cashback benefit along to its qualifying end users.⁵⁰

In this scenario, how does AT&T South Carolina's position affect the Reseller's ability to compete?

As shown in Attachment L, AT&T South Carolina is out-of-pocket \$17.50 in the first month of service (it paid a \$50 cashback to its end user and received a \$32.50 payment). By comparison, a Reseller is out-of-pocket \$4.59 in the first month of service (it paid a \$50

⁴⁸ This assumption is unduly generous to the Resellers, because the record shows that they actually price their services well above AT&T South Carolina's retail prices for the same services. *See* Taylor Rebuttal, Tr. at 107-09. As demonstrated below, replacing this \$34.50 assumption with a higher (and thus more realistic) price makes AT&T South Carolina's point even more emphatically.

⁴⁹ This is the net of the \$27.69 (\$32.50 discounted by 14.8%) the Reseller pays AT&T South Carolina for the service and the \$42.60 (\$50 discounted by 14.8%) cashback credit it receives from AT&T South Carolina.

⁵⁰ This is another assumption that is generous to the Resellers, as nothing in the record suggests that they actually pass along to their end users any of the cashback credits they already receive from AT&T South Carolina today.

cashback to its end user,⁵¹ received a \$34.50 payment from its end user, and received an \$14.91 bill credit from AT&T South Carolina). The upshot is that while AT&T South Carolina is out-of-pocket \$17.50 in a single month in order to win a customer with its cashback promotion, the Reseller is out-of-pocket only \$4.59 to achieve the same result. Far from putting a Reseller at a competitive disadvantage, AT&T South Carolina's position allows the Reseller to use the same cashback offering AT&T South Carolina uses to attract customers for a fraction of the out-of-pocket amount AT&T South Carolina incurs.

Applying more realistic assumptions to this scenario shows that a Reseller fares much better in the real world. Attachment M shows that if a Reseller's price is \$48.00 for the service, – a more realistic assumption given the evidence of record⁵² – and if the Reseller passes the full \$50 cashback benefit through to its end users, the Reseller actually nets a *positive* \$12.91 in the first month (compared to AT&T South Carolina's being out-of-pocket \$17.50 in that month). Attachment N shows the most realistic example – the Reseller's price is \$48.00, and the Reseller does not pass any of the cashback to its end users. In that example, the Reseller nets a *positive* \$62.91 in the first month (compared to AT&T South Carolina's being out-of-pocket \$17.50 in that month).⁵³

Clearly, there is no problem that needs solving. AT&T South Carolina's method allows Resellers not only to compete (if they truly were interested in competing with AT&T South

⁵¹ The Reseller does not need to provide *more* cashback than AT&T South Carolina in order to compete; it just needs to keep pace, counting on its lower monthly price for its competitive clout.

⁵² dPi's advertised prices for its services in South Carolina are at least 57% higher than AT&T's prices for similar services. Taylor Rebuttal, Tr. at 107-09.

⁵³ Indeed, this most realistic example explains why some resellers want to churn off customers after one month, sometimes to affiliate companies. Such a highly profitable first month creates strong incentives to game the system.

Carolina),⁵⁴ but to thrive (especially given that they charge their customers much more than AT&T South Carolina charges for similar services). Accordingly, there is no need to alter the long-standing application of the resale discount percentage in response to the Resellers' "wholesale is greater than retail" argument. Indeed, it would be ironic for the cries of wolf by Resellers that do not even pretend to compete with AT&T South Carolina to lead to a Commission ruling that could discourage AT&T South Carolina and other ILECs from providing these pro-competitive benefits to their end users.

d. Both of the Resellers' Proposals Distort the Commission's Avoided Cost Discount.

As explained above, Resellers' Method 1 obviously overstates avoided costs by improperly applying the Commission-approved 14.8% discount to the standard price of the service instead of to the lower promotional price as contemplated by both the FCC and the Fourth Circuit. Resellers' Method 2 also overstates avoided costs, although a bit more subtly. To see how, it is helpful to briefly review how the Commission established the 14.8% resale discount.

In 1997, the Commission used cost studies to determine the aggregate amount of "avoided costs" associated with AT&T South Carolina's retail services. It then divided that aggregate "avoided cost" figure by the aggregate revenue generated by those services, and the result is the 14.8% resale discount percentage. Because the resale discount percentage was

⁵⁴ The Resellers target low-income customers who typically have left AT&T South Carolina or another reputable provider because they could not pay their bills. (Taylor Rebuttal, Tr. at 106-07). Accordingly, the fact that some of the Resellers' customers may be former AT&T South Carolina customers does not mean that the Resellers compete with AT&T South Carolina. As Dr. Taylor explained, "[i]f the customer leaves AT&T because he's getting a better deal from one of your clients, then yes [the Reseller is competing with AT&T], but if he's leaving AT&T because he has a bill he can't pay and AT&T won't provide service to him anymore, that isn't my notion of leaving for competitive reasons." (Taylor Cross, Tr. at 142.)

developed on the basis of aggregate revenue, it produces an appropriate estimate of avoided costs only if it is applied consistently to the aggregate revenue AT&T South Carolina receives from all of its retail services. Resellers' Method 2 does not do this. Instead, as shown earlier, the Resellers indisputably propose to apply the resale discount percentage one way to what they perceive as "positive revenue" generated by "positive prices"⁵⁵ and a different way to what they perceive as "negative revenue" generated by "negative prices."⁵⁶ In doing so, Resellers' Method 2 improperly overstates the aggregate avoided cost estimate and impermissibly changes the Commission's wholesale discount.⁵⁷

Attachment O to this Brief demonstrates this concept in basic terms. Attachment O assumes AT&T South Carolina sells exactly two services: Service A to Customer 1 at a retail price of \$110 a month, and Service B to Customer 2 at a retail price of -\$10 a month.⁵⁸ In this scenario, the aggregate revenue received by AT&T South Carolina is \$100 a month, which means the estimate of total avoided costs should be \$14.80 (14.8% of \$100). As Attachment O shows, that is exactly the aggregate avoided cost estimate that AT&T South Carolina's proposal produces. Resellers' Method 2, however, improperly produces an aggregate avoided cost

⁵⁵ The Resellers appropriately would subtract the avoided cost estimate from the promotional price in these circumstances.

⁵⁶ The Resellers inappropriately would add the avoided cost estimate to the promotional price in these circumstances.

⁵⁷ Resellers' Method 2 would remove the amount of estimated avoidable costs required by the federal Act and the Commission's avoided cost orders, but it would not stop there. Instead, Resellers' Method 2 would also (and improperly) reward the Resellers by removing an *additional* amount of costs based on the difference between the cashback amount and the monthly price of the service. This approach, which produces results that have no relationship to the 14.8% resale discount percentage established by this Commission, is not permitted by the federal Act or the Commission's avoided cost orders.

⁵⁸ This example is based on Dr. Taylor's testimony during the hearing. (Taylor Cross, Tr. at 136-37; Taylor Redirect, Tr. at 173-175; Hearing Exhibit No. 13). Because the point is mathematical, it makes no difference that it would not be rational for AT&T South Carolina to sell a product at a negative price over the long term or that the Commission's rules would prevent such pricing.

estimate of \$17.76 -- \$2.96 higher than the estimate should be under the methodology adopted by this Commission. Because of this fundamental flaw, Resellers' Method 2 (like Resellers' Method 1) yields a higher avoided cost discount between retail prices and wholesale prices than that established by the Commission.

This, in turn, yields wildly varying discounts on a month-to-month basis instead of the consistent 14.8% discount required by the Commission's orders. When appropriately applied, the avoided cost discount produces a constant 14.8% difference between retail prices and wholesale prices, not only in any given month, but also in the aggregate over time. Attachment P to this Brief, for example, shows the total amounts a retail customer and a Reseller would pay, over the course of six months, for a service with a monthly retail price of \$30. In any given month, there is a 14.8% difference between the \$30 price the retail customer pays and the \$25.56 price a Reseller pays. Likewise, there is a 14.8% difference between the aggregate amount a retail customer pays for the service over any given period of time and the aggregate amount a Reseller pays for the service over the same period of time.

Attachments Q and R to this Brief show that when the one-time cashback amount is greater than the monthly price of the service, AT&T South Carolina's position appropriately maintains this same 14.8% difference over time, while the Resellers' two methods do not. These Attachments apply each of these three methods to the example Mr. Gillan discusses in Table 1 of his Direct Testimony (Att. Q),⁵⁹ and the Competitive Acquisition \$100 Reward described in Attachment A to the Stipulations for Consolidated Phase the parties filed on July 25, 2010 (Att. R).⁶⁰ AT&T South Carolina's position consistently produces not only a 14.8% difference

⁵⁹ Attachment Q uses a monthly price of \$32.50 and a one-time \$50 cashback benefit.

⁶⁰ Attachment R uses a monthly price of \$48.00, comprised of a monthly price of \$23 for Complete Choice (see Stipulations, Attachment B, General Exchange Guidebook

between the retail price and the wholesale price in the first (and every other) month of service, but also a 14.8% difference between the aggregate amount a retail customer and the Reseller pay over the same period of time. In contrast, Resellers' Method 1 never produces a 14.8% difference – and it sometimes produces differences as high as 64.1% and even 355.2%. And while the Resellers' Method 2 forces a 14.8% difference (in the wrong direction) in the first month, the error of Resellers' Method 2 is evident from the fact that when the service is kept for more than a single month, the aggregate amounts paid by the retail customer and the Reseller always improperly differ by more than 14.8% -- sometimes by as much as 49.3% and even 370.0%. The graphs included in Attachments Q and R display the erratic, drastic, and improper departure from the appropriate 14.8% difference that is generated by the two methods the Resellers propose.

e. AT&T's Method Does Not Create a Price Squeeze

The Resellers' "price squeeze" argument is based on the assumption that they must attempt to meet AT&T South Carolina's prices in order to compete. (Klein Direct, Tr. at 263-64). As Dr. Taylor explained, however, these Resellers target credit-challenged customers who cannot receive service from AT&T South Carolina, typically because they owe past-due balances. (Taylor Rebuttal, Tr. at 106-07). The Resellers, therefore, can and do charge prices that are much higher than AT&T South Carolina's retail prices for similar services. (Id., Tr. at

§A3.2.9.B.1(a)) and a monthly price of \$25 for BSLD unlimited service (*see* <http://www.bellsouth.com/consumer/ld/index.html>). This is the current price for the unlimited long distance service – the price in 2007 when the Competitive Acquisition \$100 Reward offering was available likely was higher. By using this example, AT&T does not suggest that a long distance offering should be available for resale – to the contrary AT&T South Carolina strongly believes they are not, and that issue is not before the Commission in this Consolidated Phase. Instead, AT&T South Carolina is simply using the price of this promotion to demonstrate that the Resellers' arguments in this proceeding are without merit.

107-09). This is a compelling reason – but certainly not the only reason – that the Resellers “price squeeze” argument rings hollow.

As Dr. Taylor explained in his testimony, Section 2 of the Sherman Act embodies one policy objective that is potentially implicated by a price squeeze argument (preventing the monopolization of markets by proscribing anticompetitive acts that would allow a firm to achieve market power). (Taylor Rebuttal, Tr. at 101). Reseller witness Dr. Klein, however, concedes that: he is not claiming that AT&T is trying to force the resellers out of business by creating a price squeeze; he is not claiming that AT&T has any sort of predatory intent; he is not claiming a violation of Section 2 of the Sherman Act; and in his view as an economist, there is not sufficient evidence in this docket to show a violation of section 2 of the Sherman Act. (Klein Cross, Tr. at 302-03). Clearly, the Resellers have not proved (and cannot prove) a Section 2 price squeeze.

Instead, Dr. Klein testified that he is testifying about a price squeeze in the regulatory context of the 1996 Act and the FCC’s Rules and Orders implementing the 1996 Act. (Klein Cross, Tr. at 303).⁶¹ As Dr. Taylor explained, however, “because the FCC and this Commission determined that a 14.8 percent margin is sufficient to allow efficient resellers to compete, retail and wholesale prices calculated consistently with that formula cannot violate the 96 Act and are not anticompetitive.” (Taylor Rebuttal, Tr. at 102). This point was confirmed by Dr. Klein when he testified on cross-examination that if this Commission determines and the courts affirm that AT&T South Carolina’s method complies with the resale provisions of federal law, there would be no price squeeze in the “regulatory context” about which he testifies. (*See* Klein Cross,

⁶¹ This is the another policy objective that is potentially implicated by a price squeeze argument. (Taylor Rebuttal, Tr. at 100).

Tr. at 304-06). Because AT&T South Carolina's method does, in fact, comply with federal law, there simply is no price squeeze here.

f. Adopting Either of the Resellers' Methods Would Violate the FCC's *Local Competition Order*.

The foregoing discussion makes clear that the Resellers are proposing non-uniform wholesale discount rates. The *Local Competition Order*, however, expressly states that "we allow a state to approve nonuniform wholesale discount rates, as long as those rates are set on the basis of an avoided cost study that includes a demonstration of the percentage of avoided costs that is attributable to each service or group of services." *Local Competition Order*, ¶916. The Resellers presented no cost study in this proceeding. The Commission, therefore, cannot lawfully adopt either of the Resellers' positions.

Additionally, the Resellers support their unprecedented methods by claiming that they address the Resellers' concerns that AT&T South Carolina's method, in limited circumstances, results in a greater credit for retail customers than for Resellers. As explained above, these concerns are unfounded and the Resellers' methods are solutions in search of a problem that does not exist. Even if that were not the case, however, the *Local Competition Order* clearly states that "[a]n avoided cost study may not calculate avoided costs based on non-cost factors *or policy arguments . . .*." *Local Competition Order*, ¶ 914 (emphasis added). Clearly, changing the Commission's longstanding method of calculating avoided costs in order to address the Resellers' "wholesale is higher than resale" policy arguments is not permissible.

2. The Reseller's "Rebate" Argument is Without Merit.

Implicitly recognizing the fallacies of their first wave of arguments, the Resellers have hatched a second theory, arguing that a cashback benefit is a "rebate" that is merely a "term or condition of service" that must be passed along to the Resellers in the exact same manner (and in

the exact same amount) that it is provided to retail customers.⁶² The flaw in this argument is obvious: the 1996 Act may require AT&T South Carolina to pass certain aspects of a service along to the Resellers in the same manner they are provided to retail customers, but price is not one of them. (See Taylor Rebuttal, Tr. at 89). Instead, the 1996 Act as implemented by this Commission authorizes AT&T South Carolina to establish the wholesale price of a service by applying the 14.8% resale discount rate to the retail price of the service.

Regardless of what the Resellers want to call the cashback benefit, they cannot seriously contend that it affects any aspect of a telecommunications service other than its price. As Dr. Taylor explained,

Well, the economic reasoning, which is what I speak to, is that a cashback promotion is a price reduction. Now, you can call it a rebate. You can call it a promotional price. You can call it all sorts of things. But the critical thing is, as the Fourth Circuit told us as well, is that it affects the price.

(Taylor Summary, Tr. at 120-21). This is confirmed by Reseller witness Dr. Klein, whose prefiled testimony states “[t]he cashback offer functions as a rebate, rather than a direct price discount, *but the potential effect on the reseller is the same.*” (Klein Direct. Tr. at 266 (emphasis added)).⁶³ Dr. Klein further conceded that: end users who receive a cashback “rebate” receive the same features, functionality, and quality of service as end users who do not receive the cashback “rebate,” (Klein Cross, Tr. at 314-15); “what we’re arguing about on these

⁶² See, e.g., Resellers’ Opening, Tr. at 31 (“[A] Reseller is entitled to resell that promotion and get the benefits of it on the same rates, terms, and condition that the retail customer gets.”); Klein Rebuttal, Tr. at 284 (“A rebate is a term or condition of service that must be offered to a reseller in the same manner as offered to a retail customer”) Klein Summary, Tr. at 292 (“So I think you have to see [the cashback benefit] as part of the terms and conditions of service, and not really the price.”).

⁶³ Similarly, Reseller witness Mr. Gillan’s pre-filed Direct Testimony states “[t]he cash-back promotion reduces the effective retail rate by \$50 (at least for the first month). (Gillan Direct, Tr. at 203 9). (Joseph Gillan’s Direct Testimony was entered into the record as Resellers’ Exhibit 1).

promotions is the price that should be charged” (Composite Hearing Exhibit 12, Klein Depo. at 83); and “as far as I know about what’s at issue here, that’s correct. It’s just the monetary arrangements” (*Id.* at 84). To the extent the Resellers try to draw a distinction between a price reduction and a rebate, therefore, it is a distinction utterly without a difference in the context of this Consolidated Phase.

This point is further demonstrated by the *Sanford* decision, which generally characterizes cashback promotions as “rebates.”⁶⁴ Additionally, in addressing the example of a \$120 standard monthly price and a \$100 monthly cashback benefit, *Sanford* specifically refers to “a coupon for a monthly *rebate* check for \$100.”⁶⁵ Calling the check a “rebate,” however, did not lead the Fourth Circuit to apply its hypothetical 20% resale discount to the \$120 “standard” price as the Resellers propose. To the contrary, the Fourth Circuit confirmed the North Carolina Commission’s reasoning that the resale discount must be applied to the promotional price (or effective retail price) of \$20 that results when the “monthly rebate check for \$100” is applied to the \$120 standard price for the offering.⁶⁶

3. The Results-Oriented Subjectivity Inherent in the Reseller’s Positions Creates Inconsistency and Confusion.

Perhaps the most telling indication of the invalidity of the Resellers’ positions is the confusion and inconsistency that arise from the necessarily subjective nature of their positions. Hearing Exhibits 6, 7, and 8, for example, present three scenarios in which a retail customer pays AT&T South Carolina \$30 for the first month of service. The Reseller’s witnesses, however,

⁶⁴ See *Sanford*, 494 F.3d at 442, 449.

⁶⁵ *Id.* at 450.

⁶⁶ And as explained above, this is mathematically identical to AT&T South Carolina’s method of billing Resellers the standard price discounted 14.8% and then providing qualifying resellers a bill credit in the amount of the retail value of the cashback benefit discounted by 14.8%. (Tr. at 9-10; Powerpoint Presentation at Slide 6).

claim that the wholesale price in that first month should be \$14 in two of those scenarios and \$24 in the other, depending on what they subjectively determine to be the actual “standard” offering. AT&T South Carolina respectfully submits the Resellers’ proffered “reasoning” for this disparity -- because the \$30 the retail customer pays is the result of a promotional offering in two instances and the result of a “standard retail price” in the other – is simply a distinction without a difference. The practical reality is that the retail customer pays a net of \$30 for the service in the first month under all three scenarios, and the wholesale price should be determined based on this practical reality and not on theoretical machinations about whether that is the result of a “standard price,” a “promotional price,” a “discount,” a “rebate,” or something else entirely.

The confusion generated by the Resellers’ positions is best demonstrated by considering Hearing Exhibit No. 9. The example in that Exhibit – a \$120 monthly price coupled with a \$100 monthly cashback benefit – is one that is familiar to every witness involved in this docket because it comes straight from the *Sanford* decision that Dr. Taylor addresses in detail in his Rebuttal Testimony. (*See, e.g.*, Taylor Rebuttal, Tr. at 87-89). Three weeks after this Rebuttal Testimony was pre-filed, Reseller witness Dr. Klein testified in his deposition that the wholesale price in this scenario should be “basically a monthly credit of \$4 to the resellers.” (Consolidated Hearing Exhibit 12, Klein Depo. at 37-38).⁶⁷ During the hearing, Dr. Klein testified that this remains his position if he interprets this example as creating a retail price of \$120 (which he does), but he would come to a different conclusion if he interpreted this example as creating a retail price of \$20. (Klein Cross, Tr. at 311-312.). Dr. Klein, therefore, conceded that his proposed methodology is necessarily open to “an interpretation over what the retail price is Is it a rebate, as we talked about? Or is it, you know, just some attempt to kind of disguise what

⁶⁷ This is \$96 (the standard price of \$120 discounted by 20%) less \$100 (the full retail cashback value).

the true retail rate is?” (*Id.*, Tr. at 312). Similarly, Reseller witness Mr. Gillan testified in his deposition that the wholesale price in this scenario should be negative four (a \$4 credit to the Reseller), (Consolidated Hearing Exhibit 12, Gillan Depo. at 26), yet during the hearing he testified that the wholesale price in this scenario should be \$16 (which is what AT&T South Carolina and the Fourth Circuit say).⁶⁸ (Gillan Cross, Tr. at 243).

Clearly, the Resellers’ position is a moving target, and it is whatever best serves their financial interests, as long as they can rationalize that it somehow is not inconsistent with the *Local Competition Order* or the *Sanford* decision. The truth is, the Resellers’ are simply attempting to evade the stark reality that each of their proposed methods are flawed and inconsistent with the rulings of every Court, Commission, and Agency to have considered this issue.

4. Adopting Either of the Resellers’ Proposed Methods Would Have a Chilling Effect on Promotional Offerings, to the Detriment of South Carolina Consumers.

⁶⁸ After giving this \$16 answer during the hearing, Mr. Gillan gratuitously accused AT&T South Carolina witness Dr. Taylor of “mischaracterizing” his testimony when, in his summary, Dr. Taylor used this example to “claim[] that the reseller position was they should get the discount off the \$120.” (Gillan Cross, Tr. at 243). Mr. Gillan, however, is not the only witness for the Resellers. Their other witness, Dr. Klein, testified that he and Mr. Gillan reach different conclusions with regard to this example: “Mr. Gillan looks at [this example] the second way, as a disguise and that the real retail rate isn’t \$120; it’s really \$20. And if I look at it, my first inclination is to look at it as if it’s a rebate, *and so I think that’s the difference.*” (Klein Cross, Tr. at 312). And while Mr. Gillan defended his accusation by saying “[i]t’s not the answer I gave you in Louisiana,” Mr. Gillan unequivocally stated in his deposition that under the Resellers’ proposal, the reseller would receive a \$4 bill credit every month from AT&T,” (Gillan Cross, Tr. at 246), and he gave a different answer in Louisiana, saying “I jumped one way in the deposition as I look at it here I see this looks more like a \$20 product under the way you’ve described it and I’m treating [it] like a \$20 product.” (See Attachment S to this Brief; Gillan Cross, Tr. at 246 (“The more thought I put into it, my answer changed.”). Mr. Gillan had to concede that “when asked about this hypothetical, once you said it was a negative \$4 and now twice you’ve said it is \$16,” (Gillan Cross, Tr. at 246-47). Mr. Gillan’s accusation that Dr. Taylor had “mischaracterized” the Resellers position, therefore, is sloppy at best.

In considering the foregoing discussion of why AT&T South Carolina's method of discounting the cashback amount complies with controlling law and the Resellers' various methods do not, it is important to remain mindful of the real-world context and impact of the Resellers' proposed methods. Consumers in South Carolina can choose from a wide array of communications services offered not only by ILECs like AT&T South Carolina, but also by cable companies, VoIP providers, wireless companies, and others. Like these other providers, AT&T South Carolina uses cashback and other promotional offerings to make its services attractive and competitive, and consumers in South Carolina clearly benefit from these competitive promotional offerings. Like other providers, AT&T South Carolina must carefully evaluate these promotional offerings to ensure that they remain profitable. It is axiomatic that the more expensive it becomes to offer these promotions, the less likely they are to remain available to South Carolina consumers.

AT&T South Carolina's method would give Resellers a bill credit in the appropriate amount when the cashback benefit is greater than the monthly price of a service. Under the Resellers' proposals, however, AT&T South Carolina would be required to give Resellers an additional amount of credit in these situations, above and beyond any amount Resellers would be entitled to receive under the decisions of this Commission and the FCC. This clearly would have a chilling effect on promotional offerings, because it would be irrational for AT&T South Carolina to offer cashback promotions whose costs – including inflated payouts to Resellers – exceed their benefits.

Nothing in the record suggests that either of the Resellers' proposed methods would benefit South Carolina consumers who purchase services from them. The Resellers did not rebut AT&T South Carolina's evidence that they charge their end user customers far more than AT&T

South Carolina charges them (and far more than the retail prices AT&T South Carolina charges its retail customers for the same services). And if AT&T South Carolina were required to provide Resellers additional credits beyond the amount they are entitled to receive, nothing requires Resellers to pass one penny of those additional credits along to their end users (and nothing suggests they would), and nothing prohibits Resellers from continuing to charge their end users much higher prices than AT&T South Carolina charges for similar services (and nothing suggests they would not).

II. LCCW PROMOTIONS

The second issue in this Consolidated Phase results from the Resellers' absurd contention that when AT&T South Carolina waives a line connection charge for a retail end user, it must actually *pay* a Reseller for ordering a line from AT&T South Carolina. Assume, for example, the nonrecurring installation charge for a new retail customer is \$40. A line connection charge waiver (LCCW) promotion waives this charge, and a qualifying retail customer pays zero for the line connection. (Taylor Direct, Tr. at 68-69; Stipulations at ¶¶7-9). When AT&T South Carolina resells a LCCW promotion, the Reseller is initially billed \$34.08 for the line connection,⁶⁹ and if it requests and qualifies for a LCCW promotional credit, AT&T South Carolina gives the Resellers a bill credit in the amount of \$34.08.⁷⁰ (*Id.*). Under AT&T South Carolina's method, therefore, the retail customer and the wholesale customer both pay a net amount of zero for the line connection charge. (*Id.*).

⁶⁹ This is the \$40 retail price discounted by 14.8%.

⁷⁰ Again, this verification step is necessary because resellers like dPi have systemically requested promotional credits to which they are not entitled. *See* fn. 3 above. And while nothing prevents AT&T South Carolina's service representatives from speaking to retail customers in real time to determine whether they qualify for a promotion, AT&T South Carolina's service representative are prohibited from having similar contact with the Resellers' end user customers. (Taylor Redirect, Tr. at 175-76).

The Resellers, however, shamelessly claim that instead of charging them the same net of zero that AT&T South Carolina charges retail customers, AT&T South Carolina must actually *pay* the Resellers \$5.92 when they qualify for a waiver of a line connection charge. (Composite Exhibit 12, Klein Depo. at 74; Klein Cross, Tr. 297-98).⁷¹ The Resellers are wrong for all of the reasons they are wrong about the cashback issue, and AT&T South Carolina will not recount all of those reasons here. Some points, however, do bear repeating.

First, when a LCCW promotion is resold, \$0 is the price to which the 14.8% resale discount rate is to be applied. On cross examination, Reseller witness Dr. Klein conceded that when AT&T waives the line connection charge for a retail customer, it “effectively charges a zero to the retail customer for the line connection.” (Klein Cross, Tr. at 297-98). Moreover, the 1996 Act provides that prices for resold services shall be set “on the basis of *retail rates charged to subscribers* for the telecommunications service requested,”⁷² and the Fourth Circuit explained that when an incentive like a LCCW promotion is offered, “the nominal tariff (the charge that appears on the subscriber’s bill) is not the ‘retail rate charged to subscribers’ under §252(d)(3) because the nominal tariff does not reflect the value of the incentives.”⁷³ Because \$0 is the “retail rate charged to the subscriber,” it is \$0 to which the resale discount rate is applied.

Second, discounting the \$0 retail price by 14.8% produces a wholesale price of \$0. This is not only the mathematically accurate result, but also the result envisioned by the 1996 Act. The controlling statute provides that wholesale prices shall be set “on the basis of *retail rates charged* to subscribers for the telecommunications service requested, excluding *the portion*

⁷¹ In the examples used in the deposition, the line connection charge was \$50 and the resale discount was 20%, thus Dr. Klien testified that the resellers are asking for a \$10 (\$50 X 20%) credit. In the example of a \$40 line connection charge and the Commission-approved 14.8% resale discount, the amount of credit claimed by the resellers would be \$5.92 (\$40 X 14.8%).

⁷² 47 U.S.C. §252(d)(3)(emphasis added).

⁷³ *Sanford*, 494 F.3d at 450 (emphasis added).

thereof attributable to [costs avoided by the ILEC].”⁷⁴ And on cross examination, Dr. Klein conceded that “if this Commission were to determine that some service had a regular retail rate of zero, then “there would be no attributable avoided cost under the current system of calculating avoided cost.” (Klein Cross, Tr. at 301).

Finally, as explained above in Section I.B.3, the Resellers’ positions are necessarily subjective because they turn on what the Resellers’ view as the “true” standard offering in a given scenario. Adopting their positions, therefore, would open a Pandora’s box of confusion and mischief. Assume, for example, that an older tariffed offering provides local calling at a price of \$15 per month plus 10¢ per minute of use, and a more recent tariffed offering provides unlimited local calling at a price of \$20 per month. If the Commission were to adopt the Resellers’ position, Resellers could argue that the older offering is the “true” standard offering and that the “unlimited” offering is simply a variant (or, in the words of Dr. Klein, a “disguise”) of the “standard” offering that waives the 10¢ per minute usage charge. Applying the same logic they apply to the LCCW promotions discussed below, Resellers could argue that while they owe AT&T South Carolina a net monthly payment for the “flat” portion of the service, AT&T South Carolina actually owes them a net payment for each minute of local usage their end users generate.⁷⁵ Like the CLECs who generated enormous volumes of dial-up minutes-of-use (and, therefore, claims against then-BellSouth for reciprocal compensation charges) in the late 1990’s, Resellers could gin up large volumes of usage and seek enormous payments from AT&T South Carolina if the Commission were to adopt their position in this docket. The Commission clearly should not adopt a position that would encourage this type of regulatory arbitrage.

⁷⁴ 47 U.S.C. §252(d)(3)(emphasis added).

⁷⁵ This is exactly what the Resellers erroneously argue with regard to the LCCW promotions: they owe AT&T South Carolina a net payment for the monthly price of the service, but AT&T South Carolina owes them a net payment for the waiver of the line connection charge.

III. WORD-OF-MOUTH PROMOTION

The third issue in this Consolidated Phase addresses referral marketing programs such as the “word of mouth” offering described in Attachment C to the Stipulations. Qualifying AT&T South Carolina retail customers can receive promotional benefits such as gift cards under these offerings if they convince friends and family members who are not AT&T retail customers to purchase particular AT&T services. (Stipulations, Attachment C; Taylor Direct, Tr. at 22-23). Some of the Resellers argue that AT&T must “resell” these referral marketing promotions by paying a Reseller a word-of-mouth referral benefit when one of that Reseller’s end users convinces friends and family members to purchase services, not from AT&T, but from that Reseller. (Klein Cross, Tr. at 317-18). These Resellers take this position even though their own witness, Dr. Klein, acknowledged that no resale obligation arises in any of a number of analogous situations:

Q. If AT&T pays sales personnel commissions based on the amount of new retail business they bring in to AT&T, in your view, is AT&T required to offer the services of those salespersons for resale [to a Reseller]?

A. No.

Q. If AT&T pays sales personnel commissions based on new revenue, retail revenue they generate for AT&T, is AT&T required to provide those same commissions to sales personnel who bring in new business to [a Reseller]?

A. No.

Q. If AT&T pays college students to go and place flyers under windshield wipers saying “Buy AT&T services,” is AT&T required to offer those college students’ services to [a Reseller]?

A. No

Q. And if [a Reseller] hires its own college students to put things under windshields that say “Buy [the Reseller’s] services, is AT&T required to pay those college students for [the Reseller]?

A. No.

(Klein Cross, Tr. at 318-19). The position these Resellers take is so devoid of merit that other Resellers are quick to point out that they have never claimed to be entitled to resell these “word-of-mouth” promotions.⁷⁶

These referral marketing promotions clearly are not subject to resale. Resale obligations apply only to “telecommunications services” AT&T South Carolina provides at retail,⁷⁷ and a marketing referral program like “word-of-mouth” is not even arguably a telecommunications service. In fact, as AT&T witness Dr. Taylor explained:

Soliciting new customers for AT&T is not a service that AT&T *offers to* its customers; instead, it is a marketing activity that AT&T *induces from* its customers. And even if it were somehow construed as a service provided to customers, it would be in no sense a *telecommunications* service provided by AT&T to its retail customers.

(Taylor Direct, Tr. at 73-74)(emphasis added).

Moreover, unlike the cashback offerings discussed above, these referral marketing programs have no impact on the price a retail customer pays for telecommunications services provided by AT&T South Carolina. As Reseller witness Dr. Klein conceded, if a retail customer does nothing more than purchase a telecommunications service from AT&T South Carolina, that customer does not receive any benefit under the word-of-mouth promotion. (Klein Cross, Tr. at 320; Composite Hearing Exhibit 12, Klein Depo. at 77-78). Instead, to receive a word-of-mouth benefit, a retail customer must take the additional action of contacting and convincing a person who is not an AT&T retail customer to buy a qualifying AT&T service. (Klein Cross, Tr. at 320-21; Klein Depo. at 78). And as Dr. Taylor further explained, a retail customer can receive

⁷⁶ In their respective Answers, Affordable, dPi, and NewPhone deny that they have sought promotional credits for these types of promotions.

⁷⁷ See 47 U.S.C. §251(b)(1), (c)(4).

one, two, or more payments under the word-of-mouth promotion without changing the telecommunications services she buys. (Taylor Direct, Tr. at 74). Clearly, “word-of-mouth” benefits do not impact the price a retail customer pays for retail services; instead, they reward the retail customer for actions he or she performs for AT&T South Carolina.

Reseller witness Dr. Klein conceded this point when he testified that a retail customer who convinces someone who is not an AT&T South Carolina customer to purchase an AT&T retail service “certainly” is doing something that is beneficial to AT&T in order to receive a word of mouth benefit. (Klein Cross, Tr. at 320-21). He further conceded that it is not unreasonable to view what that customer does as “marketing” AT&T South Carolina’s services. (Klein Cross, Tr. at 321-22). Whatever the 1996 Act may require AT&T South Carolina to make available for resale, benefits provided in exchange for marketing services performed for the company simply is not one of them. As explained by Dr. Taylor,

from a public policy point of view, having to resell [a word of mouth] promotion is really a bad idea. Remember how resale was supposed to work back in 1996 when they thought it up. It was the ILECs – AT&T in this case – have an advantage: they’ve got a network out there. If you ever want local competition, we’d better require that they share that network, so other firms, like the resellers here, can buy services on that network and compete with AT&T *on the non-network part of the business* – the customer service, the marketing, those things. Well, if you then require AT&T to resell at an avoided-cost discount its marketing initiatives, that just makes a mockery of the resale competition that this was all put in place to do.

(Taylor Summary, Tr. at 126)(emphasis added). Clearly, AT&T is not required to make word-of-mouth or other referral marketing promotions available for resale.

CONCLUSION

For the reasons set forth above, AT&T South Carolina respectfully requests that the Commission enter an Order finding that:

It is appropriate for AT&T South Carolina to make cashback promotional offerings available for resale by a two-step process whereby: (1) the reseller orders the requested service and is billed the standard retail price of the service discounted by the 14.8% resale discount rate established by the Commission; and (2) the reseller requests a cashback promotional credit which, if verified as valid by AT&T South Carolina, results in the reseller receiving a bill credit in the amount of the face value of the retail cashback benefit discounted by the 14.8% resale discount rate established by the Commission.

It is appropriate for AT&T South Carolina to make LCCW promotional offerings available for resale by a two-step process whereby: (1) the reseller is initially billed the standard retail price for the line connection discounted by the 14.8% resale discount rate established by the Commission; and (2) the reseller requests a LCCW promotional credit which, if verified as valid by AT&T South Carolina, results in the reseller receiving a bill credit in the amount of the standard retail price for the line connection discounted by the 14.8% resale discount rate established by the Commission

AT&T South Carolina is not required to make marketing referral promotions like the "word-of-mouth" offering available for resale.

Respectfully submitted on this the 21st day of March, 2011.



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